

# A new decade for global equity opportunities

As the markets enter 2010, value-oriented equity manager **Ron Holt** and growth-focused manager **Tom Davis** analyse strong global equity prospects in emerging markets, technology, natural resources and China.

**R**ecovering equity markets around the world posted significant gains in 2009. But as the global economy continues to be fragile and valuations higher, investors probably shouldn't look for a repeat of 2009 in terms of performance. That said, there are ample opportunities, not only for 2010 but on a longer-term basis for fundamental equity investors.

## Room for growth

The recovery has been stellar, not just in the emerging market asset class, but also in equities in general. A lot of the rebound has to do with how low equity prices got in early 2009. The MSCI Emerging Markets Index is up 73 per cent through November. But if we look back at 2008 and factor in that emerging markets were one of the worst-performing asset classes with the index down more than 50 per cent, then the prospects for continued growth today appear reasonable.

On a longer-term basis, emerging markets should be an area that provides a significant opportunity for global investors. In fact, investors may be underinvested in this asset class. The perception of higher levels of risk in emerging markets may not be accurate anymore. For example, as we come through this most recent financial crisis and look at what has happened in the global economy, the real epicenter of the crisis was in the US and the developed world.

Unlike 1998, this time emerging markets have been the stars in the global economic recovery phase. It has been the developed world that really took it on the chin – and in all likelihood will take longer to recover. According to consensus research, GDP estimates for 2010 include Brazil growing close to five per cent, China likely exceeding nine per cent and India at around 7.5 per cent. That contrasts with GDP estimates for many developed nations, where France, Germany and the UK are expected to grow around one per cent and the US at three per cent. This shows that growth still remains overwhelmingly in favour of emerging markets.

## Sectors poised for growth

Technology, more specifically consumer-related electronics such as computers, televisions and mobile handsets, looks to be a solid area of growth over the next few years. Areas where there is expansion or improvement in market penetration, again, are in emerging markets and particularly in China, where there is still a long way to go for wireless communication penetration and expansion. One example of a company with strong fundamentals and involved in the manufacturing of LED technology – which is rapidly being deployed in flat-panel television sets – is South Korea's Samsung Electro-Mechanics.

With an upward online sales trend occurring, Internet-related areas – both on the search side and e-commerce – are other interesting tech areas. There are some new growth opportunities in the Internet travel space. In fact, there is now a Chinese version of Priceline called C-Trip.

Favourable dynamics are in place in the materials sector as well. With a limited amount of resources in the world, companies that own actual physical assets that are in the ground probably give them some competitive advantages going forward. Raw materials, in particular iron ore, copper and metallurgical coal – which is a key component to steel making – are also potential growth opportunities. This area ties closely into the broader global economic recovery theme, because there can be no true recovery without a global recovery in construction.

Broadly speaking, in the energy and materials sector, the valuations have moved up quite a bit in 2009, so that is cause for concern. But fundamentally, the energy and materials sector appears to be a great place in which to be investing.

## Sustainable growth in China

As China's economic growth accelerated to 8.9 per cent in the third quarter of 2009, many investors may wonder if this growth rate is sustainable. It does appear to be quite sustainable. In fact, if US and European economies come out with some better-than-expected



results, we could actually see perhaps even stronger growth, and if not stronger, a better mix or quality of growth because we will see some of the exports come back as well.

In the absence of that, though, we have seen a fairly significant stimulus come from the Chinese government, which is focused on the domestic economy and starting domestic demand. Therefore, a lot of the stimulus will not only boost consumption of big-ticket items like automobiles and appliances, but also it should benefit the long-term development of the country – including improving the railway and

transportation systems in China and finding ways to improve the healthcare system.

Playing China for the recovery stimulus with companies in the property sector and infrastructure worked well in 2009. Moving forward, a shift toward domestic consumption, the consumer and Internet-related names may provide more growth opportunities. Overall, given the underlying growth in China and the way it has been able to power through the global crisis, it is certainly a place where good opportunities can be found, and we believe good opportunities will continue to exist.

## BRIC markets

There should be a good resumption of growth in Brazil in 2010. Brazil was one of the last countries to enter the global downturn in 2008 and one of the first to recover. Reasonable political stability for a number of years now, along with considerable improvement in the fiscal situation and underlying economic situation, has aided Brazil's progress.

Unemployment has turned positive again, while wages and income trends are encouraging – and that all feeds into support for domestic consumption. Development of the banking sector both on the wholesale and commercial retail side are other positive signs. Brazil is also in an enviable position of having natural resources such as iron ore and oil. Plus, it has a large and rather young population. There should be a continuation of further development of this market as the middle class develops.

Overall, looking at economic growth, the BRIC nations appear to have superior growth rates, and it most likely will be that way for an extended period of time. This does not appear to be a short-term phenomenon. It is a longer-term rebalancing of the global economy that is going on. These markets will be important in terms of being a significant part of that rebalancing.

A good portion of the world's population is located in these four countries that are moving from an emerging state or an

underdeveloped state to one where they are very quickly developing a significant level of the middle class, developing the infrastructure and developing the overall economy. That could be a significant story over the next 25 to 50 years.

From a valuation standpoint, most of the BRIC markets are generally still looking pretty attractive. China looks to be trading in the mid-teens multiple of earnings on 2011 numbers, Brazil in the mid- to upper teens multiple of earnings and Russia in the low to mid-teens multiple of earnings. Those are not particularly expensive multiples given where some of those countries have historically traded.


The only exception is India, which does look a bit expensive trading north of 20 times earnings in 2011. India is a more isolated economy and did not suffer as much on the downturn. But at the same time, it does not look as economically stable either. There are big deficits there. India does not have the kind of economic firepower that China does to power its way through from a stimulus standpoint or investment standpoint. The one bright spot investors like to play is the IT consulting business in India.

Moving over to Eastern Europe, Russia is not only the biggest producer of oil in the world, it is the largest supplier of natural gas in the world and has a lot of good, solid natural resources. Russia is one emerging market that continues to be cheap in terms of price/earnings ratio. A lot of that lower valuation comes from concerns about higher levels of political risk, which is certainly warranted. However, high-quality companies in Russia can be bought at very attractive multiples. Also, there are some select banks and wireless telecommunications firms in Russia with good fundamental growth opportunities.

## Commodity prices

The rapid rise we have witnessed in commodity prices in 2009 is cause for concern. With that said, longer term there

is still scope for higher prices in commodity markets. A continuation of volume growth – driven from demand coming from the resource-intensive emerging markets and the recovery expected to be ongoing in the developed markets – appears to be a likely scenario for 2010.

Taking a look at the lofty prices of gold, it remains hard to make the case for this precious metal. Gold is not really used in construction, and nor for most of the things involved in an economic recovery. So to justify the current gold prices would be a bit of a stretch. 

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